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SUBJECT: Serbia: Gas Deliveries from Germany and Hungary Continue

Ref: a) Belgrade 12 b) Belgrade 21

Summary -----

¶1. Hungary and Germany continue to deliver gas to Serbia as the Ukraine-Russia gas dispute went unresolved. The government took proactive action and decided to allow for more fuel oil imports and an increase of its reserves in the event of a protracted dispute. Serbian officials continued to blame Ukraine for the gas crisis and announced possible legal action against Ukraine. End Summary.

European Assistance Continues -----

¶2. As the Ukraine-Russia gas dispute continues, so does Serbia's dependence on emergency gas deliveries from Hungary and Germany. Director of state-owned gas company Srbijagas Dusan Bajatovic told us on January 16 that Serbia extended agreements with Hungarian MOL and German EON for urgent gas deliveries of up to two and 2.7 million cubic meters (MCM) per day, respectively until January 24. The agreements are flexible and can be discounted at any time. Bajatovic said that Serbia also succeeded in securing an additional two MCM of gas from Hungary and Germany - which he hoped would begin to flow on January 19 - to restart supply to small and medium companies, mainly in Vojvodina, which are directly connected to Srbijagas pipes. Bajatovic also thanked Hungary and Germany for their assistance and said Russia had no part in helping Serbia receive this additional gas.

Government Takes Action -----

¶3. On January 15, the government decided to allow for additional import of fuel oil and to allow Belgrade district heating power plants to borrow 7,700 tons of fuel oil from the state's reserves, if necessary. In a press conference after the recent government session, Energy Minister Petar Skundric said the decision would ensure that Serbia had enough fuel oil, should the crisis continue, and if Hungary and Germany no longer could deliver emergency supplies to Serbia. Belgrade City Assembly President Aleksandar Antic told us on January 16 that daily production of fuel oil satisfied daily consumption demand, but reserves were thinning. The government's decision would allow district heating power plants to keep three to four days worth of fuel oil in reserve.

Electricity System Overloaded -----

¶4. Milos Milankovic, director of the state-owned electricity transmission operator EMS, told us on January 14 that the electricity grid was overloaded. EMS transferred a record 175.5 million kWh on January 13, Orthodox New Year's Eve. The transfer included a record 155.5 million kWh in electricity consumption and 20 million kWh of emergency electricity supply from neighboring

countries due to thermo power plant outages in the Eastern Serbia. Some suburbs of Belgrade and Nis, Serbia's third largest city, experienced blackouts due to old distribution networks.

Ukraine to Blame

15. On January 13, both President Boris Tadic and Srbijagas head Bajatovic blamed Ukraine for the gas crisis. Bajatovic told the press that Srbijagas received a request from the government to consider legal action against Ukraine. Later in the week, Bajatovic said Russia's responsibility would be considered as well, although he believed there was no legal or economic basis to sue Russia. Conversely, Serbian Employers' Union President Stevan Avramovic told us on January 15 that the Union would file a lawsuit on behalf of its members against the Serbian government for more than \$31 million in damages and lost business caused by the gas shortage.

Energy Security

16. The gas crisis began a finger pointing game in the Serbian media for finding blame for Serbia's energy vulnerability. Critics particularly focused on finding someone to blame for the unfinished underground gas storage Banatski Dvor. According to Bajatovic, only \$30 million was needed to finish Banatski Dvor. On January 14, Milos Milankovic, EMS Director and a former Srbijagas Director, told us that Srbijagas had an open offer from Hungarian MOL to finish Banatski Dvor. He added that Serbia could have easily secured a bank loan to complete construction, but by the terms of the Gazprom deal signed on December 24, 2008, Russia would not allow Serbia to take out a loan with any other country except Russia. Gazprom negotiators had lead Srbijagas officials to believe that Gazprom

BELGRADE 00000051 002 OF 002

would withhold Russian gas that would go to Banatski Dvor, if Serbia pursued a separate loan. Milankovic also said Russia would not allow Serbia to connect to Bulgaria's gas system through a proposed 167 km long pipeline from Nis to Dimitrovgrad that would have provided an alternative to the sole pipeline connected to Hungary. The Gazprom agreement stipulated that the two countries would decide by mid-2009 whether to complete construction of Banatski Dvor. The agreement also prohibits Serbia from seeking another partner to finish Banatski Dvor until the end of 2009.

17. Serbian entrepreneur Goran Percevic, head of the Interkomerc holding company, told DCM on January 16 that Serbia needed to wean itself off of gas entirely. He said gas was a newcomer to the Serbian energy scene and that Serbia needed to return to traditional energy sources - hydro and coal - and also concentrate on developing renewable energy. Percevic said construction of a new hydroelectric plant on the Drina River would service both Bosnia and Serbia and said privatization and renovation of the Obrenovac power plant on the outskirts of Belgrade would meet Belgrade's energy needs. "But we need foreign investors for both projects," he said. DCM replied that the Serbian government would do well to pay more attention to improving its foreign investment climate and noted that the Gazprom energy deal had seemed to backfire on Serbia. "We needed the \$500 million Gazprom gave us for NIS," Percevic said, "what could we do?"

Regional Solidarity

18. The current gas crisis sparked a rare show of regional cooperation. Last week Serbia allowed urgent gas deliveries from Hungary to Bosnia-Herzegovina through Serbia. Bosnian officials applauded the gesture, approved by Serbian President Boris Tadic, as a sign of good neighborly relations. In addition, Tadic spoke with Croatian Prime Minister Ivo Sanader on the gas crisis and they agreed to have an open line of communication until the end of the crisis.

COMMENT

¶9. The Serbian government continues to place blame for the current energy crisis on Ukraine, avoiding any mention of Russia as the possible culprit. Although there is talk of a lawsuit against Ukraine, there appear to be little legal basis for one. The crisis is, however, begging the more important question of Serbia's energy security and the reality that Serbia's deal with the Russians has and will not shield it from energy vulnerabilities. End Comment.

MUNTER